

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF ENVIRO UTILITIES,)
INC., FOR AN ADJUSTMENT OF RATES)
PURSUANT TO THE ALTERNATIVE RATE) CASE NO. 9101
FILING PROCEDURE FOR SMALL UTILITIES)

O R D E R

On July 13, 1984, Enviro Utilities, Inc., ("Enviro") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). This regulation permits utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers.

Enviro's proposed rates would produce additional revenue of approximately \$20,635 annually, an increase of 38.4 percent over test-period actual operating revenues of \$53,685. Based on the determination herein, the revenues of Enviro will increase by \$1,640 annually, an increase of 2.6 percent over normalized revenues of \$63,555.

A hearing was not requested in this matter, and in accordance with the provisions of the ARF, no hearing was conducted. The decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission offices.

COMMENTARY

Enviro is a privately-owned sewage treatment plant and serves approximately 525 residential customers and 10 commercial customers in Jefferson County, Kentucky.

TEST PERIOD

The Commission has adopted the 12-month period ended December 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

For the test period Enviro reported a net operating loss from sewage operations of \$19,613. Enviro proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Enviro proposed an adjustment to actual test-period operating revenues of \$9,790 to reflect a rate increase allowed by the Commission during the test period. The Commission has

determined that the adjustment should be \$9,870 and has increased actual test-period operating revenues by that amount to reflect normalized sewage service revenues of \$63,555.

Sludge Hauling Expense

Enviro proposed to increase test-period sludge hauling expense of \$5,585 by \$1,840 to reflect an increase in the fee charged by C.F.S. Services, Inc. Enviro provided no information reflecting the determination of the proposed adjustment. However, apparently Enviro miscalculated the amount of the adjustment. To support the proposed adjustment, Enviro provided a copy of a letter from C.F.S. Services, Inc., stating that its per-load sludge hauling fee would be increased to \$155 as of July 1, 1984. Based on the number of loads of sludge hauled during the test period, the Commission has determined that the adjustment should be \$1,545.¹ This results in adjusted sludge hauling expense of \$7,130.

Electricity Expense

Enviro proposed an adjustment of \$644 to test-period electricity expense. Based on test-period usage and Louisville Gas and Electric Company rates which became effective May 14, 1984, the Commission has determined that the adjustment should be \$885. This results in adjusted electric expense of \$9,467.

Routine Maintenance Fee

Enviro reported Routine Maintenance Service expense of \$9,300 for the test period and proposed no adjustment to this

¹ $\$155 \times 46 \text{ loads} = \$7,130; \$7,130 - \$5,585 = \$1,545.$

expense. However, the test-period monthly fee of \$775 exceeds the monthly fee allowed in Enviro's most recent rate case. In its Order of January 3, 1984, in Case No. 8688, The Application of Enviro Utilities, Inc., for an Adjustment of Rates, the Commission allowed a monthly fee of \$650.

Mr. Carroll Cogan owns 100 percent of the stock of Andriot-Davidson Company, Inc., ("Andriot-Davidson") and 100 percent of the stock of Enviro. Therefore, the contract between these two entities is, by definition, not at arms length. In order to determine the reasonableness of the increased maintenance fee, the Commission requested detailed information regarding the services provided, the basis for the determination of the monthly fee, and comparative information for all sewer plants serviced by Andriot-Davidson. However, Enviro provided incomplete responses to the Commission's request. Also, Enviro rested its case in this proceeding on the response in the last case. In Case No. 8688, the Commission found that the response to requests regarding the routine maintenance contract was incomplete and denied the increase in the monthly charges. No new evidence has been offered to alter the Commission's decision in this case.

The Commission was unable to compare the services being provided to the various facilities serviced by Andriot-Davidson due to the failure of Enviro to file copies of contracts and annual data relating to actual services provided to each facility. In response to the Commission's request for documentation of negotiations with entities other than Andriot-Davidson for routine maintenance services, Enviro filed three estimates. Although

these estimates were higher than the fee charged by Andriot-Davidson, insufficient information was supplied with regard to the services to be provided by the other entities for the price quoted. In response to the Commission's inquiry as to whether Enviro had considered alternatives to contracting for the routine monthly maintenance, Enviro responded that the costs of hiring someone and handling the paperwork for employment taxes would preclude that possibility. However, no details were provided to support this contention.

The Commission has expressed concern in past Orders about the rising costs of sewer utilities and, with regard to sewer utilities owned by Mr. Cogan, the increasing complexity of inter-company transactions. At this time there has been no improvement with regard to the willingness of Mr. Cogan to disclose information concerning these affiliated company transactions. The Commission is of the opinion that again Enviro has failed to meet its burden of proof with regard to the test-period level of monthly routine maintenance expense. Moreover, no new evidence has been provided in this case to justify increasing the fee allowed in the last rate case and the Commission has thus denied the additional cost over that allowed in the last rate case for rate-making purposes herein. Therefore, an adjustment has been made to reduce the annual cost incurred during the test year by \$1,500 to reflect the annual cost of routine plant maintenance at \$650 per month which was allowed in Case No. 8688.

Insurance Expense

Enviro reported test-period insurance expense of \$745. In response to the Commission's information request of August 28, 1984, Enviro provided a copy of an invoice for property and liability insurance in the amount of \$525. Since Enviro did not provide any documentation for the additional \$220 of test-period insurance expense, the Commission cannot include the total reported expense for rate-making purposes. Therefore, the Commission has excluded \$220 of the test-period actual expense and included \$525 for rate-making purposes.

Transportation Expense

Enviro reported test-period transportation expense of \$713. An invoice from Carroll Cogan Companies, Inc., ("CCC") in the amount of \$555 listed 13 trips related to Enviro business, but did not provide the number of miles traveled. Instead, each trip was expensed at \$35. Two other trips, for a total of 398 miles, were expensed at \$.25 per mile.

The Commission is of the opinion that the transaction for car rental between CCC and Enviro is one of less than arms-length and that Enviro has not sufficiently demonstrated the travel expenses to be of benefit to its customers. Furthermore, thousands of dollars have been allowed in this case for outside service companies to maintain the plant on a routine and non-routine basis. Transportation to and from Enviro for sludge hauling and maintenance is provided for within a monthly fee or billed by vendors on a per-mile basis.

It is the Commission's policy to allow managers of like-sized sewer utilities an annual fee of \$1,800 which includes a provision for ordinary travel expense. Additional compensation must be sufficiently documented and justified. The Commission finds that Enviro has not met its burden of proof on this issue and has, therefore, disallowed reported test-year transportation expense for rate-making purposes.

Depreciation Expense

Enviro reported test-period depreciation expense of \$19,731. Because Enviro changed the depreciation rates on some plant items between 1981 and 1983, annual reports on file with the Commission were examined to determine the proper amount of depreciation expense that should have been taken for 1983, the test period. The Commission has neither approved these changes in depreciation rates in another proceeding nor does the Commission find them reasonable in this case. Therefore, based on information contained in these reports, it has been determined that the maximum depreciation expense for the test period should have been \$16,886.² However, this is without consideration of depreciation associated with contributed property. The Commission has established in numerous sewer and water utility rate cases the practice of disallowing for rate-making purposes depreciation on

²	1980 Depreciation Expense	\$10,893
	Maximum Depreciation on Plant	
	Additions - 1981-1983	<u>5,993</u>
		\$16,886

contributed property. According to the 1983 annual report, gross utility plant in service at the end of the test period amounted to \$203,966. Contributions in aid of construction totaled \$45,980 at the end of the test year. Thus, depreciation on contributed property is determined to be \$3,807, based on the ratio of contributions to gross plant. The net effect of the two adjustments is to decrease test-period depreciation expense by \$6,652. Therefore, depreciation expense of \$13,079 has been allowed for rate-making purposes.

Interest on Long-Term Debt

Enviro reported test-year interest expense on long-term debt of \$7,200. In Case No. 8688, the Commission found that the most equitable interest allowance on the lease obligation with the Ft. Candle Corporation is \$4,315, which is the average interest expense over the life of the obligation.

In response to the Commission's information request of August 28, 1984, Enviro stated it did not agree with the Commission's finding in Case No. 8688. Enviro requested the Commission to reconsider this issue and to limit the averaging of the interest expense to a maximum of 3 years, rather than over the life of the obligation, which is 13 years.

In Case No. 8688, the Commission found that allowing the average interest expense over the life of the obligation was the most equitable approach because the ratepayers would bear a fixed, equal expense over the full term of the lease rather than bearing a heavy burden in the early years and a lighter load in the later years. The annual lease payments of \$12,000 represent the annual

payback of principal and interest over the 13-year life of the lease. Of the \$12,000 annual payment, \$4,315 represents interest expense based on the 13 equal annual installments. If the average annual payment is used, the ratepayers are charged for only their share of the cost of the long-term lease. However, if the 3-year average, based on principal and interest, is used, today's ratepayers will be paying substantially more for equal utilization of Enviro's facilities. The Commission finds no reason to depart from its determination on this issue in Enviro's last case. Therefore, \$2,885 of the test-period expense has been disallowed for rate-making purposes.

Interest on Debt to Associated Companies

Enviro reported test-period interest expense on debt to associated companies of \$1,434. When questioned concerning the use of the proceeds in the Commission's information request of August 28, 1984, Enviro responded that the funds were used to support current losses. The Commission found in Case No. 8688 that to allow Enviro to recover interest expense associated with this type of debt would constitute retroactive rate-making. The Commission affirms that position in this case and has disallowed the interest expense of \$1,434 for rate-making purposes herein.

Other Interest Expense

Enviro reported test-period charges of \$3,492 to Account No. 431--Other Interest Expense. In response to Item No. 18 of the Commission's information request of August 28, 1984, Enviro stated that this amount represented interest expense on a loan from the Carroll Cogan Companies Special Loan Account ("CCCSLA")

and that the loan was taken out to pay current obligations. As explained in the previous section, allowing this interest expense would constitute retroactive rate-making and it has been disallowed, as it was in Case No. 8688, for rate-making purposes.

Enviro reported test-period charges of \$1,760 to Account No. 701-C--Other Labor, Materials and Expenses. When asked for a breakdown of this expense in Item No. 4 of the Commission's information request of August 28, 1984, Enviro stated that the account consisted of 1-1/2 percent per month service charges from various suppliers, including Andriot-Davidson, for 1983. Again, in Case No. 8688 these type of charges were disallowed because allowing them would have constituted retroactive rate-making. In this case, the Commission maintains the same position and has disallowed the service charges for rate-making purposes. Also, these service charges were improperly charged to Account No. 701-C. In accordance with the Uniform System of Accounts for Class C and D Sewer Utilities costs of this nature shall be charged to Account No. 431--Other Interest Expense.

After consideration of the aforementioned adjustments, the Commission finds Enviro's test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 53,685	\$ 9,870	\$63,555
Operating Expenses	61,172	<8,115>	53,057
Net Operating Income	\$ <7,487>	\$17,985	\$10,498
Other Income	-0-	-0-	-0-
Other Deductions	<12,126>	7,811	<4,315>
Net Income (Loss)	<u>\$<19,613></u>	<u>\$25,796</u>	<u>\$ 6,183</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio³ is a fair, just and reasonable method for determining revenue requirements in this case and finds that an operating ratio of 88 percent will allow Enviro to pay its operating expenses and provide a reasonable return to its owners. Therefore, the Commission finds that Enviro is entitled to an increase in annual revenue of \$1,640.

Inasmuch as Enviro is a Subchapter S Corporation for tax purposes, no provision for federal or state income taxes has been included in the revenue requirements determination. This treatment is accorded on the basis of the Commission's standard rate-making treatment adopted in Enviro's last rate case and used in numerous Orders rendered by this Commission for Subchapter S Corporations.

FINDINGS AND ORDERS

1. The rates in Appendix A are the fair, just and reasonable rates for Enviro and will produce gross annual revenue of approximately \$65,195.

2. The rates proposed by Enviro would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

³ Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Gross Revenue}}$

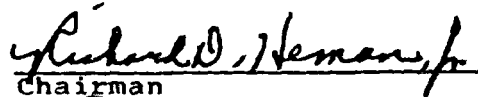
IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Enviro on and after the date of this Order.

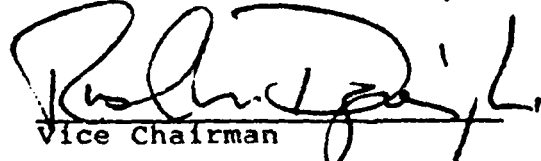
IT IS FURTHER ORDERED that the rates proposed by Enviro be and they hereby are denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order, Enviro shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 31st day of January, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9101 DATED 1/31/85

The following rates are prescribed for the customers in the area served by Enviro Utilities, Inc., d/b/a Candlelight Sewer System located in Jefferson County, Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

Single Family Residential	\$10.30
Multi-Family	8.70
Commercial and Other	10.30 per residential equivalent

A residential equivalent is defined as 6,500 gallons per month.